

Development of consumer credit in China

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Summary

Consumer credit – particularly personal consumer loans such as home mortgages and loans financing purchases of automobiles and large durable goods – has developed at a very rapid pace in China over the past decade. With the deepening reform of the house market beginning in 1998, commercial banks began to extend mortgage loans to individuals seeking to buy their own homes. Mortgage loans are now among the best assets held by China's commercial banks. However, China's policymakers and regulators are still facing challenges, including a nascent economy-wide credit information system, financial institutions with varying risk management standards and, in recent years, surging house prices. Therefore, in the context of China's macroprudential policies, the Chinese regulatory authorities have adopted a series of mortgage-related policies and regulations to mitigate and control credit risks and facilitate the healthy development of housing finance, home ownership and housing markets.

Volume of consumer credit

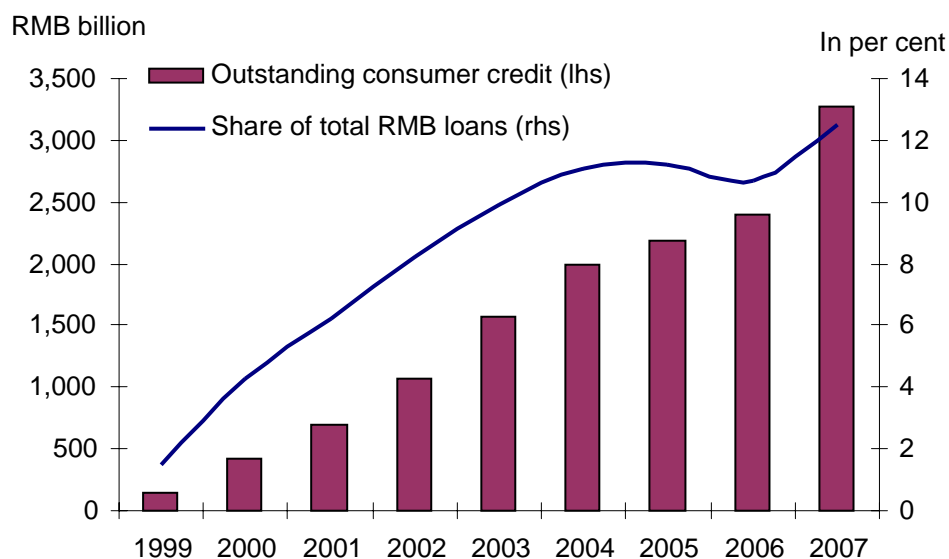
China's consumer finance market is at an early stage of development. Consumer credit is the main financing channel for households. In 2007, total outstanding loans to households increased by RMB 1.2 trillion, representing a year-on-year increase of 30.4%. This represents an acceleration of 9.3 percentage points, or RMB 546.6 billion, from the lending pace of 2006. Consumer loans outstanding, of which 80% were housing loans, increased by RMB 868.6 billion during 2007, compared with 2006. Outstanding business-related loans to the household sector increased by RMB 311.1 billion over the levels at the end of 2006.²

With the rapid development of the Chinese economy and the deepening reform of the financial system since 1998, the household lending market, especially consumer loans, has grown sharply. By the end of 2007, outstanding consumer loans reached RMB 3.28 trillion, an increase of RMB 3.14 trillion over the level at the end of 1999, representing an average year-on-year growth rate of 48% over the period. Meanwhile, as corporate direct financing gained in importance and household incomes rose, consumer loans became an increasingly important asset class for commercial banks, resulting in significant changes in the asset structure of Chinese banks in recent years. The proportion of consumer loans outstanding in total RMB bank loans in China rose to 12.5% at the end of 2007, from 1.5% in 1999 (Graph 1).

¹ The authors are staff of the Financial Market Department of the People's Bank of China (PBC). However, the views in this paper are those of the authors and do not necessarily represent those of the PBC.

² PBC, *China Quarterly Monetary Policy Report*, fourth quarter, 2007.

Graph 1
Consumer credit growth in China



Source: PBC.

RMB = renminbi.

Structure of consumer credit

The main lenders to consumers in China today are commercial banks and a number of auto financing corporations. However, mortgage loans still dominate consumer credit, even though auto loans, student loans and loans for the purchase of large durable goods have been growing rapidly in recent years. In order to promote the development of the household credit market, the PBC has put in place a series of credit policies. Documents such as “Management measures on individual housing loans” (1998), “Management measures on auto loans” (1998) and “Opinions on consumer credit development” (1999), among others, spell out the basic framework of supporting and regulatory measures adopted to facilitate the development of consumer finance.

Mortgage loans

China’s outstanding residential mortgage loans increased 142 times from 1997 to 2007, or 64% a year, on average, to reach RMB 2.7 trillion at the end of 2007. By the end of 2007, mortgage loans accounted for 82.5% of total outstanding consumer loans. In 2007, the ratio of mortgage loans to GDP reached 10.9%, compared with only 0.2% in 1997. According to the mortgage survey of 20 big Chinese cities conducted by the PBC in 2007, the average size of a home mortgage loan is RMB 274,000, the average maturity is 15.6 years and the average down payment is 37.4%.

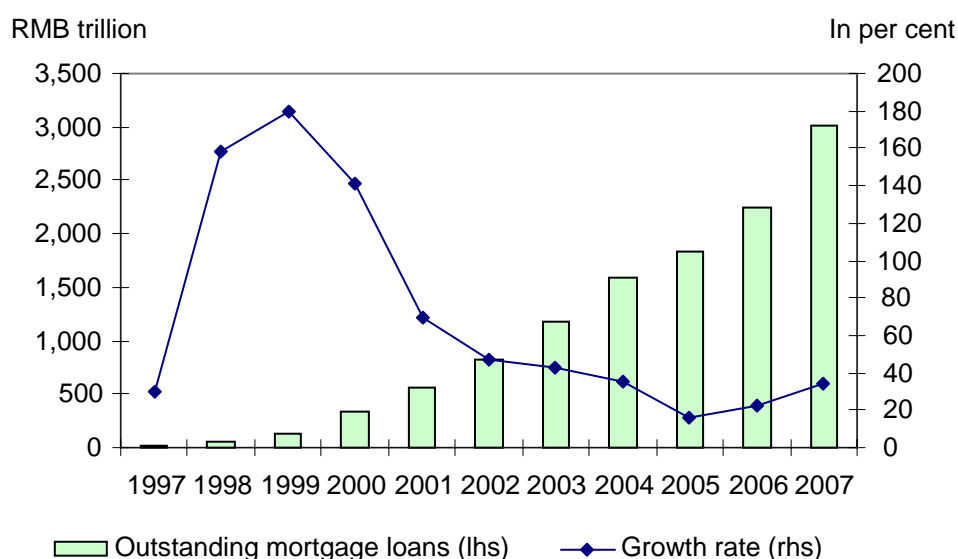
Besides commercial banks, another source of housing finance available to homebuyers in China is the Housing Provident Fund (HPF) system. Out of a pool of funds contributed by employers and their employees, an HPF provides long-term financing to employees of HPF members for the purchase, building, rebuilding and repair of owner-occupied houses or apartments. The typical structure of an HPF consists of the following five key elements: (1) the decision-making body is the HPF management committee; (2) the HPF management centre operates the fund and implements the decisions of the management committee;

(3) a special account is set up at a commercial bank; (4) the HPF management centre extends consignment loans through commercial banks; and (5) the local fiscal authorities supervise the HPF. The interest rates on HPF deposits and loans are usually lower than benchmark commercial interest rates. They are proposed by the PBC and approved by the State Council upon collection of comments from the Ministry of Construction. All of the major cities, and other cities whose districts have their own HPFs, are required to set up HPF management committees and HPF management centres.³

Recently, HPF loans have grown rapidly. By the end of 2007, outstanding HPF loans reached RMB 472 billion, equal to about 17.5% of the outstanding stock of residential mortgages held by commercial banks, and representing year-on-year growth of 33.3%.

Today, state-owned commercial banks, joint stock commercial banks, local banks and foreign banks in China all provide mortgage loans to homebuyers. However, the four main state-owned banks (Industrial and Commercial Bank of China, Agriculture Bank of China, Bank of China and China Construction Bank) still account for about 68% of total mortgage lending by banks. Commercial banks provide 79.4% of total housing loans, while local HPF management centres provide 11.9%.⁴

Graph 2
Mortgage loan growth in China



Source: PBC.

RMB = renminbi.

Auto loans

In 1998, the PBC released “Management measures on auto loans” as a guideline for commercial banks. Auto loans grew quickly from 2001 to 2003. By the end of 2003, outstanding auto loans approached RMB 184 billion, more than three times the level at the end of 2001. However, the growth of auto loans slowed significantly beginning in 2004. In

³ PBC, *China Real Estate Finance Report*, 2004 and 2007.

⁴ PBC, “Mortgage survey of 20 big cities”, 2007.

order to stimulate auto lending, the PBC and the China Banking Regulatory Commission (CBRC) adopted a series of measures to guide the auto loan operations of both commercial banks and auto financing companies. The result was a modest recovery and, by the end of 2007, the amount of outstanding auto loans reached RMB 110.7 billion. However, auto loans still account for only 3.4% of total consumer loans in China.

Student loans

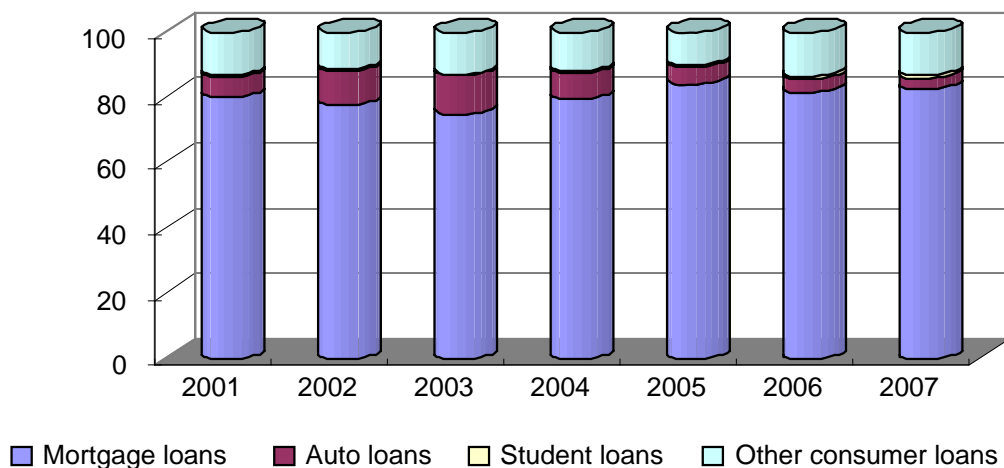
With the government subsidising loans to certain groups of students, student loan products have become more diversified. There are three main types of student loans: (1) national, (2) local and (3) commercial. Only students from poor families who meet all of the specified conditions, including passing an income test, can apply for national and local student loans, both of which are subsidised. By the end of 2007, total outstanding student loans reached RMB 23.8 billion, 8.6 times as much as the total in 2001, but student loans still accounted for less than 1% of total consumer loans in China.

Other consumer loans

Besides mortgage loans, auto loans and student loans, other forms of consumer credit include loans for the purchase of large durable goods, home decoration and travel. These types of loans have also developed quickly, reaching RMB 440.7 billion by the end of 2007, or 13.4% of total consumer loans in China.

On the whole, the current structure of consumer loans in China is consistent with the country's level of economic development and credit culture.

Graph 3
Composition of household lending in China
 As a percentage of total



Source: PBC.

Growth of housing loans

Main drivers of the growth in housing loans

One of the main drivers of the growth of housing loans in China has been the rapid development of the housing market since 1998. With the reforms of the housing market, the basic rules and frameworks for residential real estate taxes, land use and mortgage financing have been gradually taking shape. Between 2000 and 2007, housing investment in China grew by more than 20% every year, with funds coming from a wide range of investors.

Second, Chinese citizens' living standards have improved considerably over time. In 2006, average living space per person reached 27 square meters, compared with 6.7 square meters in 1978. Between 2003 and 2006, an average of 600 million square meters of new urban housing was completed annually.

Third, the house financing market itself has improved over the years. As discussed above, the PBC has issued a series of rules and regulations, such as "Management measures on individual housing loans" (1998), to encourage commercial banks to lend money to homebuyers. Under these rules, borrowers must purchase home insurance in order to protect the mortgage lender's interests in the event of damage to the mortgaged property.

Fourth, the HPF system, officially introduced in 1992, has also been steadily improving. As of the end of September 2007, the number of employees participating in the HPF system reached 100 million, deposits totalled more than RMB 1.5 trillion, in cumulative terms, and outstanding deposits exceeded RMB 900 billion. About 42 million employees improved their living standards through withdrawals from their own deposits at the HPF as well through loans extended by the HPF.

Fifth, a secondary market for residential mortgages has developed quickly since 2005. Policymakers have actively promoted asset-backed securitisation pilot projects. The development of securities backed by commercial mortgages is also under way, and such securities will be issued before long.

Main challenges in China's housing loan market

The recent acceleration of the growth of housing loans is one of the challenges facing the market for home mortgages. Between end-2006 and end-2007, outstanding housing loans increased by RMB 761.4 billion to reach RMB 3 trillion, which represents a year-on-year increase of 33.8% and an acceleration of 14.6 percentage points over 2006. Meanwhile, the amount of outstanding HPF loans also grew, by 33.3%.

A second challenge is the growing competitiveness of this market. Real estate loans, especially residential mortgages, are still the best and most important assets on the balance sheets of commercial banks. However, in order to increase market share, some commercial banks' branches may have loosened loan standards and shortened the loan investigation process. These activities may have undermined the safety of bank assets, especially mortgage loans.

Most recent policies

In August 2007, the State Council released a directive called "Opinions on dealing with the housing difficulties of low-income families". In accordance with the directive, related government ministries have proposed and implemented a series of measures designed to increase the supply of affordable housing and low-cost rentals. As a result, the housing supply structure is beginning to improve. This important directive also requires further measures aimed at discouraging excess speculation in the housing market.

In September 2007, the PBC and CBRC jointly issued the “Notice on strengthening management of commercial real estate credit”, which modifies some of the regulations governing individual housing loans. According to the Notice, commercial banks may not extend new or additional mortgage loans or facilities on the basis of a reappraisal of a mortgaged property before the original mortgage is completely paid off.

As for those borrowers applying for second mortgages, down payments must be above 40% of the appraised value of the property, compared with 20–30% in the case of first mortgages, and the lending rate must be at least 1.1 times the benchmark lending rate for the same maturity. Both the down payment and the lending rate increase substantially as the size of the mortgage loan increases.

Upon receiving an application for an individual housing loan, commercial banks must check into the applicant’s personal background and search the National Corporation and Individual Credit Information Database (see below) for records of past and existing housing loans.

In the fourth quarter of 2007, the increase in outstanding residential mortgage loans was only 60% of the increase in the previous quarter. However, it is too early to say whether this was due to the new policies.

Consumer financing products innovation

With the development of China’s financial markets, product innovations are more frequent. Recently, commercial banks have promoted a large number of new products, including fixed-rate mortgages, grace period loans, relay mortgages and reverse mortgages, among others. These innovations have improved the efficiency of bank management and expanded the choices available to homeowners. In the secondary market, mortgage-backed securities (MBS) and securities backed by auto loans have also developed very quickly. By the end of 2007, RMB 7.18 billion worth of MBS, and RMB 1.99 billion worth of securities backed by auto loans, had been issued.

At the same time, the payment habits of consumers and the ideas of bank management have changed. Credit card operations have become the main channel through which commercial banks lend small amounts to consumers. By the end of 2006, a total of about 49.59 million credit cards had been issued.

Trends in the development of consumer loans

On the whole, China’s consumer loans growth has accelerated, mainly because of the following factors.

First, in the past five years the Chinese economy has developed quickly and grown at a robust rate. From 2003 to 2007, GDP grew, on average, by about 10.6% annually on a year-on-year basis, while household incomes rose sharply. Between 2003 and end-2007, the average disposable income of Chinese citizens living in urban areas increased by RMB 5,314 to RMB 13,800, or 62.7%. The growth in disposable income spurred the development of consumer loans.

Second, the social security system, which includes the pension system, the public health system as well as low-income and disability support system, developed further, stimulating consumer demand. Since 2001, the total assets of the social security fund have expanded significantly, reaching \$70 billion by the end of 2007, an increase of more than 600%.

Third, the credit environment improved gradually with the development of with the development of market infrastructure. The PBC began developing the National Corporation and Individual Credit Information Database in 2003. By the end of 2007, the number of corporations in the database reached 6 million, and the number of individuals was over 600 million, allowing commercial banks to price loans appropriately, based on a borrower's credit record, so as to meet different consumers' financing needs.